

August 23, 2006

Mary L. Cottrell, Secretary
Department of Telecommunications and Energy
One South Station
Boston, MA 02110

Re: Response to the Comments of the Attorney General; D.T.E. 06-5

Dear Secretary Cottrell:

On behalf of Massachusetts Electric Company and Nantucket Electric Company d/b/a National Grid ("National Grid" or "Company"), I am responding to the Attorney General's August 16, 2006 comments in this docket. In his comments, the Attorney General opposes National Grid's request for approval of an increase in its base transmission service rates on September 1, 2006.

The proposed increase is based on two factors: (1) known changes in the level of Reliability Must Run ("RMR") costs billed to National Grid since it first presented its 2006 forecast in its January 27, 2006 filing in this docket ("January 2006 Filing"), and (2) the elimination of a one-time credit that New England Power Company provided in 2005 but was reflected in the test year used to develop the Company's original forecast contained in the January 2006 Filing. The Attorney General's comments focus on the RMR costs, and thus these comments will as well.

In short, the Attorney General's comments mischaracterize the issue before the Department. The question before the Department is not whether the Company may recover RMR costs, but if current cost recovery is more appropriate than generating a deferral that would be recovered from customers in the future. The Company believes that current cost recovery is the more appropriate path to follow. The underlying RMR costs arise from RMR contracts which are exclusively under the jurisdiction of the Federal Energy Regulatory Commission ("FERC"). The costs have, unfortunately, turned out to be far greater than National Grid had forecast at the time it made its January 2006 Filing for rates to be in effect for the period March 1, 2006 through February 28, 2007 ("2006 Period"). As described more fully below, the Company has proposed to raise transmission rates for the remainder of the 2006 Period in order to mitigate the effect of a large under-recovery, the recovery of which would be reflected in the transmission rates which would be put into effect beginning March 1, 2007. This is consistent with the Company's transmission recovery mechanism, which allows the Company to file for factor change adjustments whenever significant over- or under- recoveries occur.

Transmission Recovery Mechanism

National Grid recovers transmission costs pursuant to its Transmission Service Cost Adjustment Provision (M.D.T.E. No. 977-D). This provision was first approved as part of the Company's restructuring plan in D.P.U./D.T.E. 96-25 and approved again in the rate plan settlement approved at the time of the New England Electric System/Eastern Utilities Associates merger in D.T.E. 99-47. (Both of these dockets involved Department approval of settlement agreements to which the Attorney General was a party.) Under this provision, National Grid recovers transmission costs billed by New England Power Company, any other transmission provider, the New England Power Pool, a regional transmission group, an independent system operator, or any other entity that is authorized to bill the Company directly for transmission services. The transmission factors, calculated separately for each rate class, are established annually based on a forecast of transmission costs, and are fully reconcilable. The Company may file to change factor adjustments at any time should significant over- or under- recoveries occur. Recovery of RMR costs fall under the Transmission Service Cost Adjustment Provision, for they are a charge billed by the Independent System Operator – New England ("ISO-NE").

On January 27, 2006, National Grid filed its original transmission expense estimate of approximately \$175 million for the 2006 Period. This estimate was based on a forecast of transmission costs, as required under the Transmission Cost Service Adjustment Provision. Following increased actual spending much greater than forecasted, due primarily from the increased RMR costs, National Grid filed on August 1, 2006 to increase the adjustment factors, as allowed by the Transmission Cost Service Adjustment Provision. As Ms. Susan Hodgson stated in her August 1, 2006 supplemental pre-filed testimony, the Company now estimates transmission expense of approximately \$269 million for the 2006 Period. Accordingly, the Company has proposed a mid-year adjustment to its transmission rates in order to avoid a significant under-recovery of transmission costs, which would have a corresponding impact on customers' bills next year.

Attorney General's Contentions

The Attorney General argues that there is no evidence that the recovery of RMR costs is reasonable or that the costs were prudently incurred. (August 16, 2006 letter, pp. 2-3) This is incorrect. RMR contracts are cost-of-service, or fixed charge, contracts implemented by ISO-NE, and are subject to FERC approval. (Pre-filed supplemental testimony of Susan Hodgson, p. 4). ISO-NE bills National Grid for its allocated share of RMR costs. Under the "filed rate doctrine," rates filed or fixed with FERC must be given binding effect by state utility commissions determining intrastate rates. Nantahala Power and Light Company v. Thornburg, 476 U.S. 953, 962, 106 S.Ct. 2349, 2354 (1986). A utility's costs based on a FERC-filed rate must be treated as a reasonable operating expense for the purpose of setting an appropriate retail rate, and a state utility commission can not review the reasonableness of a FERC-filed rate in a proceeding to establish retail rates. Eastern Edison v. Department of Public Utilities, 388 Mass. 292, 299, 446 N.E.2d 684, 688 (1983) (citations omitted). The Department must accord deference to rates either fixed or merely accepted for filing by the FERC. Id., 388 Mass. at 304; 446 N.E.2d at 691 (citations omitted). The Attorney General's statement that "[s]imply because National Grid incurred costs

under FERC tariffs does not mean that they may automatically recover the costs from retail customers” (August 16, 2006 letter, p. 3) is inconsistent with the filed rate doctrine.

The Attorney General’s statements about the Company’s obligation to provide reliable service at the lowest cost to customers (August 16, 2006 letter, p. 3), while generally correct, are irrelevant. The Company does not dispute this general statement of its obligation. The Company notes, however, that none of the Massachusetts cases the Attorney General cites have anything to do with the issue at hand: the collection, at retail, of costs incurred under FERC jurisdictional contracts through a transmission cost adjustment provision. Instead, they have to do with the cost of long-term debt and preferred stock (Massachusetts Electric Company, D.P.U. 95-40, p. 83 (1995)); expenses for Mass-Save, Inc’s residential energy conservation program (Mass-Save, Inc., D.P.U. 95046, p. 10 (1995)); electric industry restructuring in Massachusetts (Electric Industry Restructuring, D.P.U. 95-30, at 1-2 (1995)); imprudent practices during the Pilgrim 1 outages which were imputed to a purchaser of the capacity, Commonwealth Electric Company, because of the terms of the contract it had with the owner, Boston Edison Company (Commonwealth Electric Company v. Department of Public Utilities, 397 Mass. 361, 491 N.E. 2d 1035, cert. denied, 481 U.S. 1036 (1987)); and approval of a settlement agreement between the Attorney General and Colonial Gas Company relating to Colonial Gas Company’s “total revenue requirement, depreciation rates, net plant in rate base, cost allocations/rate design, and treatment of certain revenues generated by non-firm sales and by pipeline capacity releases” (Boston Gas Company, D.P.U. 93-78, p. 3 (1993)). The New Hampshire case cited by the Attorney General supports a conclusion opposite of what the Attorney General argues. In that case, the New Hampshire Supreme Court stated quite clearly that “federal preemption of State authority requires that the wholesale rate fixed by FERC binds the PUC, to the extent that the PUC may not disapprove a rate even in light of [a state statute].” Appeal of Sinclair Machine Products, Inc., 126 N.H. 822, 825, 498 A.2d 696, 699 (1985). In that case, the New Hampshire Supreme Court remanded the case for the New Hampshire Public Utilities Commission to review whether Connecticut Valley Electric Company had acted reasonably in purchasing under a FERC-approved rate given the other purchase options available to the utility. Id. at 835, 498 A.2d at 705. The Attorney General correctly does not contend that National Grid has alternative purchase options to pursue. Instead, the Attorney General’s criticisms relate to the level of RMR costs. (August 16, 2006 letter, p. 3)

National Grid shares the Attorney General’s concern about the level of RMR costs. Although the Attorney General summarily dismisses the pre-filed testimony of Mr. Philip J. Tatro, Mr. Tatro does explain how current and future transmission improvements will greatly mitigate RMR costs for Massachusetts customers. For example, National Grid’s transmission affiliate has implemented \$58 million of transmission system upgrades that resolve the RMR need for the Salem Harbor generating station. These upgrades include substantial additions and modifications to the Ward Hill substation, the addition of two 115 kV capacitor banks at the Salem Harbor substation, reconductoring portions of three 115 kV transmission lines, and associated transmission system upgrades at the E. Methuen substation. (Pre-filed testimony of Philip J. Tatro, p. 10; *See also* D.T.E. 04-66 and D.T.E. 03-128) This work will be supplemented by the Wakefield Junction substation project, the third leg on the stool supporting improvements on the North Shore. The Potter and Fore River plants are another example. ISO-NE initially identified the need for an RMR contract for these plants to prevent overloads and voltage violations in the Southeast Massachusetts

area, but the NStar 345 kV upgrades and application of operating procedures has negated the need for an RMR. (Pre-filed testimony of Philip Tatro, p. 10). As Mr. Tatro's testimony demonstrates, similar efforts elsewhere will have similar effects. With a large transmission affiliate which is working aggressively on a significant number of transmission projects that address reliability issues, National Grid has taken an active role in seeking to mitigate RMR costs. National Grid believes that efforts to enhance and construct a robust transmission system will ultimately be more beneficial to customers than cost of service litigation at FERC on RMR contracts.

The Attorney General also states that National Grid's proposed increases are "overstated and designed to insure an over-recovery of transmission costs." (August 16, 2006 letter, p. 2). This is incorrect. National Grid's initial transmission forecast for the 2006 Period was based on a forecast, as required by the Transmission Cost Adjustment Provision. As Ms. Hodgson explains in her supplemental testimony (pp. 5-6), National Grid's actual costs have been much higher than forecasted. If FERC adjusts RMR costs downward following litigation, the reduced costs will be reflected in the transmission reconciliation. National Grid is only proposing to increase its transmission rates for the remainder of the 2006 Period. The transmission rates for the one year period commencing March 1, 2007 will be set in the Company's next annual retail rate filing which will be based upon a new forecast prepared shortly before that filing is made. If any RMR contracts are terminated or amended, any transition payments are made, or any refunds received, they will be reflected in National Grid's forecast. (For example, the Attorney General notes that the Exelon New Boston Unit 1 is no longer needed for reliability once NStar's 345 kV line has been placed in service. National Grid agrees that this event will likely result in reduced RMR costs for the Northeast Massachusetts reliability zone, but the timing of when these costs will stop being billed is unclear.) Since the Transmission Service Cost Adjustment Provision requires the Company to set its transmission rates at least annually as part of the annual retail rate filings, the risk of overstating rates are low, especially in light of the Company's ability to request a mid-year adjustment to the transmission rate in the event of a significant over- or under- recovery. In this instance, National Grid is faced with a significant under- recovery of transmission costs, but the mechanism would be appropriate should the Company experience an over- recovery as well.

In addition, since the revised forecast discussed by Ms. Hodgson only covers the 2006 Period, it is appropriate to reflect transition payments under the Forward Capacity Market structure applicable to the 2006 Period only. When the Company files its new transmission expense forecast for the March 2007 through February 2008 period, it will include the appropriate level of transition payments associated with the active RMR contracts for this twelve-month period, and will do so for every future annual retail rate filing that includes a transmission expense forecast which reflects RMR contracts receiving transition payments.

Finally, National Grid notes that, contrary to the Attorney General's allegation, there is simply no reason to "design" an over-recovery of transmission costs, which will be fully reconciled in the next annual retail rate filing. As Ms. Theresa M. Burns testified, National Grid has already incurred significantly monthly under- recoveries of transmission costs through April 2006 and has continued to incur monthly under recoveries since that date. (Supplemental pre-filed testimony of Theresa M. Burns, p. 4) By the end of the Company's reconciliation period, September 2006, the Company fully expects to have an under- recovered balance that it will seek to recover from its

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customers through a reconciliation adjustment factor. The Company merely proposes to increase its transmission rates to recover, on a going-forward basis, the higher level of transmission costs it is incurring today. These rates would be in effect through February 28, 2007 and will be replaced with transmission rates resulting from a new transmission expense forecast for the March 2007 through February 2008 period.

Conclusion

National Grid seeks Department approval to implement the revised transmission rates for usage on and after September 1, 2006. As with the rates that the Department approved, subject to further investigation, for implementation March 1, 2006, National Grid recognizes that these rates would be subject to investigation as part of the Department's overall review in this docket. The Department, in allowing the rates for the 2006 Period to go into effect on March 1, 2006, found that the rates were in compliance with G.L. c. 164, § 1B(b), National Grid's restructuring plan approved by the Department in D.P.U./D.T.E. 96-25 and D.P.U./D.T.E. 97-94, National Grid's merger settlement approved in D.T.E. 99-47, and Department precedent. For the reasons set forth above, National Grid's current request for a September 1, 2006 transmission rate increase is also in compliance with these precedents, and should be allowed to go into effect.

Thank you very much for your time and attention to this matter.

Very truly yours,

A handwritten signature in black ink, appearing to read "Amy G. Rabinowitz". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Amy G. Rabinowitz

cc: Service List